

Internal Revenue Service

Number: **202033005**

Release Date: 8/14/2020

Index Number: 355.01-01, 355.03-00,
355.07-00

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:CORP:1
PLR-127359-19

Date:
May 13, 2020

Legend

Distributing =

Controlled =

State A =

Q Sub 1 =

Q Sub 2 =

Settlor =

Trust =

Trustee A =

Trustee B =

Sibling 1 =

Sibling 2 =

Sibling 3 =

Sibling 4 =

X =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

Date 5 =

Business A =

A =

B =

C =

D =

Dear

:

This letter responds to your letter dated November 1, 2019, and supplemental communications requesting a (1) significant issue ruling; and (2) transactional ruling relating to the federal income tax consequences under Internal Revenue Code (the “Code” or “IRC”) sections 355, 368, and related Code provisions. The information submitted in your letter and supplemental communications is summarized below.

This letter is issued pursuant to Rev. Proc. 2017-52, 2017-41 I.R.B. 283 regarding one or more “Covered Transactions” under section 355 and/or section 368 of the Internal Revenue Code and pursuant to section 6.03(2) of Rev. Proc. 2019-1, 2019-1 I.R.B. 1, regarding one or more significant issues under section 355 and 368 of the Code.

The significant issue ruling contained in this letter only addresses the significant issue involved in the transactions described in this letter. This Office expresses no opinion via the significant issue ruling as to the overall tax consequences of the transaction for which a significant issue ruling is requested or as to any issue not specifically addressed by the rulings below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalties of perjury statement executed by an appropriate party. This Office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process.

This Office has made no determination regarding whether the Distribution (as defined below): (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of the earnings and profits of the Distributing corporation or the Controlled or both (see section 355(a)(1)(B) and Treas. Reg. § 1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled, or any predecessor or successor of Distributing or Controlled, within the meaning of Treas. Reg. § 1.355-8T (see section 355(e)(2)(A)(ii) and Treas. Reg. § 1.355-7).

Summary of Facts

Distributing, formed under the laws of State A, is an accrual basis Subchapter S corporation, which is engaged primarily in Business A. It was formed on Date 1. One of Distributing’s founders was Settlor. Distributing has outstanding A shares of stock, all of which are held by Trust as the sole shareholder. Sibling 1, Sibling 2, Sibling 3 and Sibling 4 (the “Siblings”) are the remaindermen beneficiaries of Trust.

Distributing owns all of the outstanding stock of Q Sub 1 and all of the outstanding interests in Q Sub 2, both disregarded entities for federal income tax

purposes. Each of Q Sub 1 and Q Sub 2 owns land that is unrelated to Distributing's Business A operations.

Controlled, formed under the laws of State A, is an accrual basis corporation formed to effectuate the proposed transaction. Controlled has outstanding B shares of stock, all of which are held by Distributing.

Distributing owns approximately C acres of land and leases another D acres of land. It is on this land that Distributing engages in Business A. Distributing has submitted financial and employment information indicating that it is actively engaged in Business A and represents that it has gross receipts and has documented operating expenses representing the active conduct of a trade or business for each of the past five years.

Settlor created Trust on Date 2 and funded it with all of the outstanding shares of Distributing. Trust elected to become an Electing Small Business Trust ("ESBT") on Date 3, the same day Distributing made its Subchapter S corporation election. Settlor and Trustee A served as co-trustees of Trust until Settlor's death, at which point Trust became irrevocable and Trustee A became the sole trustee.

Other than some cash in a bank account, Trust's sole asset is all the outstanding shares of Distributing. Under the terms of Trust, Trust shall terminate upon: (a) the last to die of Settlor, Trustee A, and X; and (b) either: (i) the youngest of Trustee A's children (Sibling 1, Sibling 2, Sibling 3 and Sibling 4, referred to in the aggregate as the Siblings) attains age 25; or (ii) the last survivor of Trustee A's children dies before attaining age 25. Upon termination, Trust's stock ownership in Distributing is to be transferred free of Trust in equal shares to each of the Siblings.

Trustee A died on Date 5. Settlor, Trustee A and X have passed away and the Siblings are all over age 25. Trust is terminating, and its ownership of Distributing's stock has vested in the Siblings equally. Because of considerable disagreement amongst the Siblings regarding the operation of Business A, the Siblings requested that Trustee B facilitate a settlement amongst them with respect to Distributing before terminating Trust and distributing to each of them his/her equal interest in the corpus of Trust. The settlement devised by Trustee B and approved by the Siblings is as follows (the "Proposed Transaction"):

Proposed Transaction (some of the steps have already been consummated):

1. On Date 4, Distributing organized Controlled.
2. Distributing shall timely elect to have Controlled treated as its qualified Subchapter S Subsidiary, effective as of Controlled's date of organization.

3. In exchange for all of Controlled's stock, Distributing will contribute to Controlled approximately one-half of the C acres of land now owned by Distributing, including any and all buildings and improvements situated thereon ("Contributed Land"), as well as certain assets and liabilities (in the aggregate, the "Contribution") pursuant to an Agreement and Plan of Reorganization ("Plan"), which will also provide --

a. To the extent necessary, Controlled and Distributing will enter into an agreement or arrangement that would allow the Siblings access to their respective homes situated on the land to be distributed to Controlled. Alternatively, the homes may be moved.

b. Any obligations for bank loans and mortgages affecting the land now divided between Distributing and Controlled shall be shared equally by Distributing and Controlled until refinanced by such corporations.

c. Any existing mortgages or home equity lines of credit secured by the land now divided between Distributing and Controlled may be paid in full by Trust prior to the distribution or continue to be an obligation of the Siblings.

d. Distributing may retain the right to continue to lease the D acres of land it currently leases for its operations.

e. Distributing will have direct access to the water shed vital to the Business A operations of both corporations. Distributing and Controlled will enter into a water access and piping easement in connection with catching, storing and moving water from Distributing's land to Controlled's land via the existing water infrastructure. The cost to maintain the water infrastructure will be shared equitably.

f. After the Distribution, Controlled will have direct access to a water reservoir. Distributing and Controlled will enter into an agreement permitting Distributing's representatives reasonable travel across Controlled's land to access the reservoir.

g. Trustee B and the Siblings will outline an equitable percentage of Business A assets which will be retained by Distributing or transferred to Controlled.

h. Distributing will transfer approximately one-half of outstanding receivables or the proceeds from such receivables to Controlled.

i. Distributing will transfer to Controlled machinery and equipment, including office equipment, vehicles, furniture and fixtures, etc. not specifically identified with either Distributing or Controlled, as they agree, or if they are unable to agree, as Trustee B shall decide in Trustee B's sole discretion.

j. Distributing will transfer a one-half interest in the assets of or one-half of the stock ownership in Q Sub 1 to Controlled. If Q Sub 1's assets are sold before the closing occurs, the net proceeds shall be added to cash.

k. Distributing will transfer a one-half interest in the assets of or one-half of its membership interest in Q Sub 2 (after conversion to a multiple member LLC) to Controlled. If Q Sub 2's assets are sold before the closing occurs, the net proceeds shall be added to cash.

l. Distributing will distribute one-half of its interest in undeveloped coastal land to Controlled. If this property is sold before the closing occurs, the net proceeds shall be added to cash.

m. The balance from any outstanding accounts payable shall be paid equally by Distributing and Controlled.

n. Distributing's employees will either stay with Distributing or move to Controlled depending on how the Siblings and employees shall agree. The corporations shall not have or share common employees.

o. Distributing's Qualified Retirement Plan shall be divided between Distributing and Controlled, subject to the approval of the Internal Revenue Service, in proportion and according to the current employees covered by the Qualified Retirement Plan retained by each after the Closing Date. Account balances and liability for payment of benefits to former employees shall remain with Distributing.

p. Distributing will transfer cash and other assets not specifically identified above to Controlled to the extent necessary to equalize the net worth of Distributing and Controlled.

q. The ultimate values of Distributing and Controlled may be properly redetermined, necessitating adjustments to the above-mentioned distributions. In the event there are insufficient cash and other assets to equalize such values, Trustee B shall equalize such values, by reallocating assets, borrowing funds, creating a debt obligation between Distributing and Controlled, or such other means as the Trustee B determines, in the Trustee B's sole discretion, to be the most appropriate means to accomplish equalization. All transfers from Distributing to Controlled will be in furtherance of equalizing the net worth of the two corporations.

4. Trust will transfer to Distributing one-half of the outstanding shares of Distributing stock in exchange for all the outstanding shares of Controlled stock. Trust will either distribute: (A) all outstanding shares of Distributing's stock equally to Sibling 3 and Sibling 4 and all outstanding shares of Controlled's stock equally to Sibling 1 and Sibling 2; or (B) all outstanding shares of Distributing's stock equally to Sibling 1 and Sibling 2 and all outstanding shares of Controlled's stock equally to Sibling 3 and Sibling 4 (the

“Distribution”). After the Distribution, Distributing will be wholly owned by Siblings 1 and 2 or Siblings 3 and 4, and Controlled will be wholly owned by the other Siblings.

5. After the Distribution, both Controlled and Distributing will be actively engaged in Business A, the historic business of Distributing and Controlled. Distributing and Controlled will each use in their Business A operations the historic business assets previously employed by Distributing in the operations of Business A.

6. Controlled will make a timely S-Corporation election.

Shareholders Before and After Distribution:

The income beneficiaries of Trust have passed away. Trust is terminating. The remaindermen of Trust are currently entitled to receive the Trust corpus, which consists of both principal and income, and the remaindermen are entitled to receive such Trust corpus in equal shares. Trust holds mere legal title to the Distributing shares; the remaindermen (*i.e.*, the Siblings) are the vested owners, not Trust. Trust continues pursuant to court order solely at the behest of the Siblings.

Representations:

Except as set forth below,

1. Trustee B makes all the representations in section 3 of the Appendix to Rev. Proc. 2017-52 in the form set forth therein.
2. Trustee B does not make the following representations, which do not apply to the Proposed Transaction: 5, 6, 20, 24, 25, 35, 36, 37, 38, 39, and 40.
3. Trustee B makes the following alternative representations set forth in section 3 of the Appendix to Rev. Proc. 2017-52: 3(a), 8(a), 11(a), 15(a), 22(a), 31(a) and 41(b).

Transactional Ruling:

Based solely on the information submitted and the representations made, we rule as follows with respect to the Proposed Transaction:

1. The Contribution, followed by the Distribution, will qualify as a reorganization under IRC § 368(a)(1)(D) and Distributing and Controlled will each be “a party to a reorganization” within the meaning of IRC § 368(b).
2. No gain or loss will be recognized by Distributing on the Contribution (IRC §§ 361(a) and 357(a)) to Controlled.

3. No gain or loss will be recognized by Controlled on the Contribution (IRC § 1032(a)).
4. Controlled's basis in each asset received from Distributing in the Contribution will be the same as the basis of such asset in the hands of Distributing immediately before the Contribution (IRC § 362(b)).
5. Controlled's holding period for each asset received from Distributing in the Contribution will include the period during which Distributing held that asset (IRC § 1223(2)).
6. No gain or loss will be recognized by Distributing on the Distribution (IRC § 361(c)(1)).
7. No gain or loss will be recognized by (and no amount will otherwise be included in the income of) any shareholder of Distributing upon receipt of Controlled stock in the Distribution (IRC § 355(a)).
8. The basis of the shares of Controlled in the hands of its shareholders immediately after the Distribution will be the same as the basis of the Distributing shares surrendered in exchange thereof (IRC § 358(a)(1)).
9. The holding period of the Controlled shares received by each shareholder in the Distribution will include the holding period of the Distributing shares surrendered in exchange therefor, provided that the Distributing shares were held as a capital asset in the Distributee's hands on the date of the Distribution (IRC § 1223(1)).
10. Earnings and Profits, if any, will be allocated between Distributing and Controlled in accordance with IRC § 312(h) and Treas. Reg. § 1.312-10(a).
11. Distributing's accumulated adjustment account immediately before the transaction will be allocated between Distributing and Controlled in a manner similar to the manner in which Distributing's earnings and profits will be allocated under IRC § 312(h) in accordance with Treas. Reg. § 1.1368-2(d)(3) (Treas. Reg. §§ 1.312-10(a) and 1.1368-2(d)(3)).
12. Pursuant to Treas. Reg. § 1.1361-5(b)(1)(i) (and(C)), the Distribution will cause a termination of Controlled's Q-Sub election because Controlled will cease to be a wholly owned subsidiary of Distributing, an S corporation.
13. For federal income tax purposes, Controlled will be treated as a new corporation acquiring all of its assets and assuming all of its liabilities from Distributing immediately before the termination of Controlled's Q-Sub election in exchange for the stock of Controlled.

14. The momentary ownership by Distributing of the stock of Controlled, as part of the reorganization under IRC § 368(a)(1)(D), will not cause Controlled to have an ineligible shareholder for any portion of its first taxable year under IRC § 1361(b)(1)(B), and will not, in itself, render Controlled ineligible to elect to be an S Corporation for its first taxable year.

15. If Controlled otherwise meets the requirements of a small business corporation under IRC §1361, Controlled will be eligible to make a subchapter S election under IRC § 1362(a) for its first taxable year, provided that such election is made effective immediately following the termination of the original Q-Sub election.

Significant Issue Ruling:

Based solely on the information submitted and the representations made, we rule that Sibling 1, Sibling 2, Sibling 3 and Sibling 4 are the shareholders of Distributing for purposes of satisfying the shareholder control requirement of IRC § 368(a)(1)(D), and the continuity of interest requirement of Treas. Reg. § 1.355-2(c)(1).

Procedural Statements:

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representative.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the letter ruling.

Sincerely,

Douglas C. Bates
Branch Chief, Branch 4
Office of Associate Chief Counsel (Corporate)

cc: